BEFORE THE DEPARTMENT
OF PUBLIC SERVICE REGULATION
OF THE STATE OF MONTANA

In the matter of the proposed amendment of ARM 38.5.1902 pertaining to cogeneration and small power production	))))	NOTICE OF ADOPTION AND AMENDMENT

TO: All Concerned Persons

1. On July 26, 2007, the Department of Public Service Regulation published MAR Notice No. 38-2-198 regarding notice of public hearing on the amendment of the above-stated rule at page 1020 of the 2007 Montana Administrative Register, issue number 14.

2. A public hearing was held on August 28, 2007. Five people testified at the hearing. Four written comments, including three from people who testified, were received by the August 28, 2007 deadline.

3. The department has thoroughly considered the comments and testimony received. A summary of the comments received and the department's responses are as follows:

COMMENT #1: NorthWestern Energy (NWE) filed comments supporting the adoption of Alternative A but with a QF size limit of 5 MW rather than 10 MW.

RESPONSE: The department appreciates NWE's support for Alternative A. The department is not persuaded that the asserted advantages of a 5 MW limit exist. For the reasons set forth in responses to comments #2 through #4, the department rejects NWE's request to set the size limit at 5 MW. The department also notes that this rule applies to all investor-owned utilities in Montana, not just NWE.

COMMENT #2: NWE asserted that a 5 MW size limit would help ensure robust responsiveness to NWE's future Requests for Proposals (RFPs) in part because it faces a market place with a single dominant supplier.

RESPONSE: The department is not persuaded that setting a size limit at 5 MW rather than 10 MW will have any appreciable effect on the robustness and results of future RFPs. NWE did not offer any evidence as to the number of potential QFs that would be between the 5 MW and 10 MW size and that would not participate in future RFPs. The department acknowledges that NWE is faced with the presence of a single large supplier that dominates the Montana market. The department is not convinced that the participation of potential QFs between 5 MW and 10 MW will either alleviate or worsen this situation.

COMMENT #3: NWE stated that a 5 MW size limit would encourage the development of "community renewable energy projects."

RESPONSE: The department acknowledges that the size limit for community renewable projects is 5 MW and that NWE must acquire approximately 42 MWs of electricity from community renewable projects by 2010. However, under either a 5 MW or a 10 MW size limit, community renewable energy projects that otherwise qualify as QFs will be eligible for the standard offer long-term contract provided for in ARM 38.5.1902. Support of community renewable energy projects requires an increase from the current 3 MW size limit but is not harmed by an increase beyond the 5 MW size limit.

COMMENT #4: NWE stated that a 5MW limit would lessen the possibility of QFs compromising the ability of NWE to manage its production portfolio in a least cost manner and may make it increasingly difficult and costly to comply with system reliability requirements.

RESPONSE: The department appreciates that NWE, as a balancing area authority without generation, faces unique and difficult challenges in operating its system in a reliable manner. This situation may change. NWE has informed the department that it is investigating the feasibility of acquiring generation. Further, the department addressed NWE's concerns in Orders 6501(f) and 6501(g) by establishing a 50 MW installed capacity limit for new QFs and by requiring that contracts between NWE and wind QFs must include specific wind integration provisions. The department is not persuaded that size of individual QFs rather than their total capacity is a significant determinant of reliability issues.

COMMENT #5: John Hines and Frank Bennett of NWE offered oral comments at the hearing that summarized and explained NWE's written comments.

RESPONSE: The responses to Comments #1 through #4 respond to Mr. Hines and Mr. Bennett's oral comments.

COMMENT #6: United Materials of Great Falls (United) and Exergy Development Group (Exergy) filed comments supporting the adoption of either Alternative A or Alternative B, both of which would raise the maximum capacity to 10MW for small QF contracts at standard long-term tariffed rates. They stated that developers of small QF projects need a simple, straightforward mechanism for contracting and do not have the resources need to participate effectively in competitive solicitations. They also stated that concerns about the effect of a utility being required to buy large amounts of QF power are mitigated by the capacity limit established in order 6501(f), the relatively low price contained in NWE's contract with PPL Montana, the fact that a wind QF's production of average annual energy will be only 30% to 40% of its capacity factor, and the requirement that QF contracts address wind integration.

RESPONSE: The department appreciates United and Exergy's support for amending ARM 38.5.1902 and agrees that small QFs up to 10 MW need a simplified mechanism for obtaining long-term contracts to sell electricity.

COMMENT #7: Whitehall Wind, LLC, Green Hunter, LLC, and Two Dot Wind, LLC (collectively Developers) filed comments stating that Alternative A is the most desirable of the proposed alternatives it is far from ideal. The Developers stated that they did not support Alternative B. The Developers stated that they believed Alternative C to be the worst option.

RESPONSE: The department appreciates the Developers qualified preference for Alternative A that it adopted. The department rejected Alternatives B and C.

COMMENT #8: The Developers recommended that the Alternative A size limit for standard offer contracts be 20 MW. They note that FERC, in Order 688, found that a reasonable and administratively workable definition of small is 20 MW and that there is a presumptive need for access to markets by small QFs. The Developers assert that the department should provide nondiscriminatory access to markets for QFs up to 20MW by having standard offer contracts available to them.

RESPONSE: FERC reached its finding in a rulemaking docket dealing with circumstances justifying the termination of a utility's obligation to purchase electricity from QFs. A FERC rule, 18 C.F.R. 292.304(c)(1), requires the department to make standard offer contracts available to QFs with a design capacity of 100 kW or less. FERC did not modify this rule when it issued Order 688. Developers attempt to equate the issue of nondiscriminatory access with the issue of standard offer contracts. The department finds that these are separate issues and that FERC's findings with respect to nondiscriminatory access provide little, if any, guidance regarding standard offer contracts. The department rejects the Developers' request to set the size limit at 20 MW.

COMMENT #9: The Developers commented that rules should acknowledge that the Least Cost Planning Advisory Committee no longer exists and has not existed for some time.

RESPONSE: The department finds that neither ARM 38.2.1902(5) nor the rules referenced therein, ARM 38.5.2001 through 38.5.2012, mention a Least Cost Planning Advisory Committee. The department concludes that Developers are requesting some action beyond the scope of this rulemaking and rejects the request.

COMMENT #10: The Developers offer an Alternative D that would change the size limit to 20 MW and eliminate the current requirement that a QF larger than the size limit go through a competitive solicitation. Developers assert the requirement is inconsistent with § 69-3-603, M.C.A., and acts as a barrier to QF entry that results in QFs receiving less than the utility's full avoided cost.

RESPONSE: The legality of the competitive solicitation requirement is a central issue in a pending court action between one of the developers and the commission, *Whitehall Wind, LLC v. Public Service Commission*, No. DV 03-10080 (Fifth Judicial District, Jefferson County). Further, the suggested revisions cannot be implemented in this rulemaking. The suggested revisions are beyond the scope of the rule notice and would require another rulemaking. The department acknowledges that the size limit for community renewable projects is 5 MW and that NWE must acquire approximately 42 MWs of electricity from community renewable projects by 2010.

COMMENT #11: Michael Uda, representing the Developers, offered oral comments at the hearing that summarized and explained the Developers' written comments.

RESPONSE: The responses to Comments #7 through #10 respond to Mr. Uda's oral comments.

COMMENT #12: The Montana Consumer Counsel (MCC) filed comments opposing adoption of any of the three alternatives. MCC stated that PURPA "requires the utility to buy projects, good or bad, that come in the door." MCC asserted that granting isolated installations of less than 10MW access to a standard offer contract can only result in higher costs to the utility and ratepayers. MCC stated that all three alternatives carry costs and risks for ratepayers and the utility with little or no corresponding benefit other than to the promoters of projects who can take advantage of them. MCC also stated that Alternatives B and C contain greater potential risk and damage for ratepayers than Alternative A.

RESPONSE: MCC appears to take issue with the mandates in PURPA and Title 69, Chapter 3, Part 6, MCA. The department must implement and enforce those mandates. The department may not adopt rules that frustrate the policy choices made by Congress in enacting PURPA and the legislature in enacting Title 69, Chapter 3, Part 6, MCA. QFs providing service under standard offer contracts will result in higher costs to ratepayers and the utility only if the standard offer rates exceed the utility's avoided cost and the provisions in Orders 6501(f) and 6501(g) regarding wind integration are ignored. There is no evidence that the standard offer rates exceed the utility's avoided cost. The department concludes that Alternative A does not contain substantial costs or risks for ratepayers and the utility.

COMMENT #13: Larry Nordell offered oral comments at the hearing that summarized and explained the MCC's written comments.

RESPONSE: The responses to Comment #12 respond to Mr. Nordell's oral comments.

COMMENT #14: Mike Costanti of Matney-Franz Engineering commented that ratepayers are affected by QFs, that he believed it preferable that QFs be locally owned, that NWE is required to purchase electricity from community renewable

energy projects (Creps), that the size limit for Creps is 5 MW, and that he opposed all alternatives but supported NWE's proposal to increase the size limit for standard offer contracts to 5 MW.

RESPONSE: Law does not permit the department to adopt rules for QFs that discriminate against out-of-state ownership. As stated in Response to Comment #3, an increase in the standard offer size limit beyond 5 MW does not harm community renewable energy projects.

4. The department has amended ARM 38.5.1902 exactly as proposed in Alternative A.

/s/ Greg Jergeson
Greg Jergeson, Chairman
Public Service Commission

/s/ Robin A. McHugh
Reviewed by Robin A. McHugh

Certified to the Secretary of State December 10, 2007.